(referring to must-carry provisions).[74] The leased access requirements are content based,[75] and subject to the highest degree of first amendment scrutiny.[76]

Even if the requirements are content neutral, they must meet the *O'Brien* test (*United States v. O'Brien*, 391 U.S. 367, 377 (1968)), the intermediate level of scrutiny applied to content neutral regulations that impose an incidental burden on speech. *Turner Broadcasting Sys.*, 114 S. Ct. at 2469. Under *O'Brien*, a content neutral regulation will be sustained only if:

> 'it furthers an important or substantial governmental interest; if the governmental interest is unrelated to the suppression of free expression; and if the incidental restriction on alleged First Amendment freedoms is no greater than is essential to the furtherance of that interest.'

Id. (quoting United States v. O'Brien, 391 U.S. at 377).

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[74] Courts have seriously questioned the constitutionality of leased access. *See Quincy Cable TV, Inc. v. FCC*, 768 F.2d 1434, 1452 (D.C. Cir. 1985); *FCC v. Midwest Video Corp.*, 440 U.S. 689, 700 & n.19 (1979) (finding that leased access negates "editorial discretion otherwise enjoyed by broadcasters and cable operators alike" and that first amendment challenges to the rules were "not frivolous"); *Preferred Communications v. City of Los Angeles*, 754 F.2d 1396, 1401 n.4 (9th Cir. 1985), *aff'd*, 476 U.S. 488 (1986) ("leased access requirements . . . pose particularly troubling constitutional questions. Imposing access requirements on the press would no doubt be invalid.").

[75] "The interest in ensuring access to a multiplicity of diverse and antagonistic sources of information, no matter how praiseworthy, is directly tied to the content of what the speakers will likely say." *Turner Broadcasting Sys.*, 114 S. Ct. at 2477 (O'Connor, J., dissenting).

[76] "[T]he First Amendment, . . . does not countenance governmental control over the content of messages expressed by private individuals. . . . Our precedents thus apply the most exacting scrutiny to regulations that suppress, disadvantage, or impose differential burdens upon speech because of its content." *Turner Broadcasting Sys.*, 114 S. Ct. at 2458-59 (citations omitted).

It is not enough, however, for the government to simply "posit the existence of the disease sought to be cured." 114 S. Ct. at 2470 (quoting *Quincy Cable TV, Inc. v. FCC*, 768 F.2d 1434, 1455 (D.C. Cir. 1985)). The government must "demonstrate that the recited harms are real, not merely conjectural, and that the regulation will in fact alleviate these harms in a direct and material way." *Id.* (citing *Edenfield v. Fane*, 507 U.S. 761, 762 (1993)); *Los Angeles v. Preferred Communications, Inc.*, 476 U.S. at 496 ("This Court may not simply assume that the ordinance will always advance the asserted state interests sufficiently to justify its abridgment of expressive activity") (internal quotation marks omitted); *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 36 (D.C. Cir. 1977) ("[A] 'regulation perfectly reasonable and appropriate in the face of a given problem may be highly capricious if that problem does not exist.'") (citation omitted).

In order to satisfy the *O'Brien* test, therefore, the rules governing leased access must serve an important government interest unrelated to the suppression of free expression and must be narrowly tailored to serve that interest. 114 S. Ct. at 2470. In other words, the government must show that there are viable commercial program services kept out of the market by cable operators, that such market foreclosure impairs diversity and competition in programming, and that the proposed rules, including the compensation formula, are narrowly tailored to further the government's interest in promoting diversity.

The government has made no such showing. Neither the Congress, before amending the leased access provisions,[77] nor the Commission, before promulgating

[77] *See* S. REP. NO. 92, 102d Cong., 2d Sess. 29-32 (1991) (discussing various theories as to why leased access provisions have not been much used, concluding that "the existing provision does not work well and requires revisions"; no empirical findings);

implementing regulations,[78] made any empirical inquiry into the basis for and probable market consequences of the leased access rules. The questions that were *not* answered, or even asked, include: Are there viable programming services that are being kept out of the market because cable operators refuse to lease to them? If so, would competition and diversity be increased if operators were to carry such services? Are there actual constraints on speech as a result of these rules, *i.e.*, are cable operators forced to drop programming they would choose to carry in order to make way for leased access?

The leased access requirements are not based on empirical findings, are not tailored appropriately to serve a legitimate government interest and do not advance diversity and competition in program services in a direct and material way. They require cable operators to drop diverse, competitive, viable, commercial programming services that operators would otherwise choose to carry. They do not meet the *O'Brien* test and are, therefore, incompatible with the First Amendment.

XII. REQUEST FOR FURTHER RECONSIDERATION.

In its Order, the Commission adopted certain rules for which TCI requests further reconsideration.

H.R. REP. NO. 934, 98th Cong., 2d Sess. 47-55 (1984) (explaining provisions and congressional intent; no empirical findings).

[78] The *Report and Order* adopting the leased access rules was frank in its admission that the record was inadequate, noting that "we did not receive a large response relating to leased access issues." *Report and Order*, *supra* n.48, at ¶ 491.

A. Cable Operators Should Not Be Required To Lease Channel Time In Half Hour Increments

The Commission should not require cable operators to accept part-time leased access contracts in half hour increments. The present rule, by allowing for increments as short as half an hour, merely invites a flood of infomercial and 900 number programming that is damaging to cable operators in at least three ways.

First, excessive infomercial programming will have a negative impact on the market development of cable television systems.[79] The Commission itself has distinguished between programming and commercials in other contexts.[80] Programming is intended to inform or entertain the viewer whereas advertising seeks to sell a product. Nothing in the text of the Cable Act suggests Congress intended to wholly abandon this distinction between programming and commercials. Indeed, it is doubtful that Congress ever intended that commercials would be considered "programming" for the purposes of leased access. At least one court has specifically ruled that "these [leased access] provisions have no application to commercial advertising."[81] Moreover, the Commission should not encourage use of leased access for half hour infomercials by mandating the leasing of channel time in half hour increments.

Second, there already exists a competitive commercial market for half hour program increments, which market is undermined and jeopardized by the availability of half

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[79] Talmey-Drake Survey (Attachment G) at 2.

[80] *See, e.g.*, Policy and Rules Concerning Children's Television and Programming, *Report and Order*, 6 FCC Rcd. 2111, 2112 (1991).

[81] *Sofer v. United States*, No. 2:94 CV 1182, slip op. at 8 (E.D.Va. June 7, 1995).

hour leased access slots at subsidized rates. Scores of broadcast and cable programming services are constantly compiling programming schedules consisting of half-hour programs. There is ample opportunity for a quality programmer to secure distribution on one of these many networks.

Both cable operators and broadcast stations are in the business of selling advertising time, and increasingly, this sale of advertising time includes the sale of half hour blocks for infomercials. TCI's half hour infomercial rates are substantially higher than the leased access rates calculated using the current highest implicit fee formula. For example, in the Denver system, the non-prime time half hour infomercial rate is $400.00 and the prime time rate is $575.00. In the Seattle system, the non-prime time rate is $300.00 and the prime time rate is $400.00. Leased access rates are substantially below these levels. Leased access was not intended to interfere with active commercial markets that already provide ample access for unaffiliated programmers. Requiring cable operators to lease channel time in half hour increments greatly harms the financial condition of cable operators and provides no benefit to the programming marketplace.

Third, when existing programming is displaced by small increments of leased access time (such as one half hour), subscribers are confused and existing programmers are harmed. As discussed above, the harm to cable operators, subscribers and programmers when existing programming is displaced by leased access programming is much greater than the proportion of programming time that is preempted. When cable operators and broadcasters sell half-hour infomercial time, they run the infomercials as "filler" programming. Regular programming is not preempted. For example, cable operators often sell infomercials on unused portions of PEG and local origination channels. Therefore, cable programmers, and the cable system's market development, are not harmed. Because leased access requires preemption of exciting programming, subsidization of leased access use by infomercial providers greatly harms cable operators.

B. Local Retransmission Consent Stations Should be Excluded In Calculating Leased Access Requirements.

The Commission finds in its *Order* that only must carry channels may be excluded from the calculation of the leased access set-aside requirements. The Commission argues that Section 612 excludes from the set-aside calculation only those channels "required for use by federal law or regulation."[82] The Commission cites legislative history which indicates that local PEG channels are not "expressly required under federal law" and then states that the same rationale applies to retransmission consent channels.

The Commission is incorrect to argue that because local PEG channels are not required by federal law that the same is true of retransmission consent stations. Federal regulation **does** specifically require the carriage of all local commercial television stations if those stations request must carry.[83] The cable operator has no control over the selection made by the local commercial television station between must carry and retransmission consent. From the perspective of the cable operator, all channel lineup and programming decisions must be made with the assumption that each qualified local television station will select must carry. Thus, every one of the cable operator's channel allocations for local commercial

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[82] Communications Act, Section 612(b)(1), 47 U.S.C. § 532(b)(1).

[83] 47 C.F.R. § 76.64(f).

television stations are "required for use by federal law or regulation." Further, no local television station would abandon its federally required must carry status unless it was confident of its continued carriage under a retransmission consent selection. Therefore, **all** local television stations that **qualify** for must carry status should be excluded from the calculation of leased access channel set-asides, regardless of the regulatory treatment selected by the local broadcaster.

C. Elimination Of Home Shopping Commissions And The Highest Premium Penetration Level Could Result In Existing Services Migrating To Leased Access.

In revising its current highest implicit fee formula, the Commission determined that (1) home shopping commissions should be eliminated from the implicit fee calculation,[84] and (2) the implicit fee calculation for premium services should be based on the average number of subscribers that subscribe to the operator's premium services, rather than the number subscribing to the most highly penetrated premium service.[85] These rule changes could lead to significant migration of these two types of services from existing cable channels to leased access. The Besen/Murdoch Report observes that prevention of just this kind of migration was a principal purpose of the Commission's development of the 1992 highest implicit fee formula.[86]

It is obvious that if the Commission's leased access rate is too low, existing shopping channels will shift to leased access to avoid the current 5 percent commission

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[84] *NPRM* ¶ 37.

[85] *NPRM* ¶ 39.

[86] Besen/Murdoch Report (Attachment A) at 18-19.

typically paid to cable operators. Additionally, if the implicit fee for premium channels is too low, highly penetrated premium services will leave the cable operator's lineup in order to sell directly through the subsidized leased access rates. As the Besen/Murdoch Report concludes, migration is still a real danger if the leased access rate is substantially reduced.[87]

The Commission has previously recognized that the migration of existing services to leased access creates no additional diversity for cable subscribers. The Commission should take great care, particularly if there is any reduction in the maximum leased access rate, to ensure that the elimination of home shopping commissions and the use of average premium subscribers does not simply result in moving existing cable services from the cable operator's lineup to leased access channels.

D. Leased Access Requests Must Be In Writing And The Cable Operator Must Have Fifteen Business Days To Respond.

The Commission's pending rules should be revised to specifically require that all leased access requests be made in written form. The Commission's determination in its *Order* that leased access requests may be made by telephone or in person will generate tremendous confusion, administrative inefficiency and ongoing disputes as to when a telephone call was made and what exactly was said or requested in the conversation. The requirement that a potential leased access user write a letter request imposes only a *de minimis* burden upon the leased access user and results in tremendous administrative efficiencies. Such a procedure will avoid numerous disputes as to the timing and content of

[87] *Id.* at 20.

oral exchanges between potential leased access users and cable operators—many of which would end up in the Commission's lap.

The Commission should extend the response time provided to cable operators to fifteen business days from the date of receipt of the written request. The Commission's requirement that cable operators respond within seven days to leased access requests will create unnecessary administrative costs and cause omissions and errors in hurried responses. No unreasonable delay will result if operators are allowed fifteen business days to respond to leased access requests and such time will allow the operator to provide the kind of detailed response required by Commission's rules.[88]

E. Providing Leased Access Capacity Information Is Burdensome And Unnecessary.

TCI requests that the Commission eliminate the requirement that cable operators provide all potential leased access users with information about how much set-aside capacity is available. Potential leased access users are interested in determining whether a channel is available for their leased access programming. Assuming there is at least one channel available, there should be no additional need for information as to how many other leased access channels remain available. Considering the complex formula used to calculate the leased access channel requirement, and the fact that changing circumstances (such as rebuilds and new must carry and leased access channels) continually affect the calculation, requiring the cable operator to provide this unnecessary information each time a leased access

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[88] *See* 47 C.F.R. § 76.970(e) (revised).

request is received will burden the operator and slow its response time with no corresponding benefit to the leased access user.

F. Reasonable Security Deposits Should Be Allowed.

TCI agrees with the Commission's determination in its *Order* that operators should be allowed to request reasonable security deposits for the use of leased access channel time. Because leased access use requires displacement of existing programming services and the corresponding economic loss from that displacement, it is more than reasonable to require a security deposit to ensure that cable operators do not go wholly uncompensated for the imposition of leased access carriage. Given that the size and financial profile of potential leased access users can vary greatly, the Commission should not attempt to set minimum or maximum security deposit levels.

XIII. CONCLUSION

Section 612 is explicit in its mandate that leased access should not be harmful to the operation, financial condition and market development of cable systems. The Commission's proposal is contrary to this mandate in many respects. The Commission should revise its proposed rules, and reconsider the rule changes set out in the *Order*, so that harmful consequences are avoided.

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ATTACHMENT A

AN ECONOMIC ANALYSIS OF THE FCC'S CABLE LEASED ACCESS PROPOSAL

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May 15, 1996

1. Introduction

The Federal Communications Commission has recently proposed significant changes in the terms on which programmers can obtain leased access to cable television systems.[1] In particular, the Commission's proposal would cause a substantial reduction in the rates paid by channel lessees and an important change in the placement of their services in cable system line-ups. Depending on the manner in which the proposal is implemented, it could have a number of major effects on cable television operators, program services, and subscribers. These effects include: (1) a reduction in the revenues and profits of cable operators as a result of lost subscribers, reduced basic subscriber rates, and diminished local advertising sales; (2) the displacement of a large number of the program services that currently are carried on the Basic Service and Cable Program Service Tiers; (3) a reduction in the revenues and profits of those program services that remain on the basic tiers; and (4) the migration of existing program services.

This paper presents an economic analysis of the likely impact of the Commission's proposal. In particular, it critically evaluates the pricing rules that are intended to compensate cable operators for the profits they forego when they accommodate leased access program services. The Commission has indicated

[1] Federal Communications Commission, Order on Reconsideration of the First Report and Order and Further Notice of Proposed Rulemaking, In the Matter of Implementation of Sections of the Cable Television and Consumer Protection and Competition Act of 1992: Rate Regulation, Leased Commercial Access, MM Docket No. 92-266, CS Docket No: 96-60, Adopted: March 21, 1996, Released: March 29, 1996; henceforth cited as Order

that it wishes to determine accurately the opportunity costs to cable operators of carrying leased access services and to compensate the operators fully for these costs. However, identifying the opportunity costs that result from foregone subscriber and advertiser revenues on a particular channel is a difficult task, and one that is only exacerbated by the fact that the revenues for any particular service are likely to depend on the other services the operator offers. Cable operators will be undercompensated unless leased access fees reflect all of these opportunity costs. As this paper shows, the Commission's current proposal ensures that operators will suffer economic harm. Indeed, the fact that leased access services require the Commission's intervention indicates that those services cannot pay the true opportunity costs of their carriage and instead require operators to subsidize their entry.

Section 2 explains that the Commission's proposed method for estimating the opportunity costs of displacing an existing program service with a leased access programmer produces estimates that are substantially below the full magnitude of these opportunity costs. As a result, the Commission's proposal would certainly adversely affect cable system operators.

Section 3 begins by discussing how cable television operators choose among the many program services that compete to be carried on their systems. It explains the sources of the net revenues that accrue to a cable operator when it adds a program service to its line-up, including the impact of carrying the service on the revenues the cable operator can obtain from the other services it carries. The sum of these net revenues permits cable operators to cover the costs of constructing and operating their systems and is critical to their economic success. The section finds that these net revenues would likely be substantially reduced if leased access programmers were to replace existing program services. Section 3 explains why the proposal could lead to the displacement of a significant number of existing cable program services and why, for similar reasons, the Commission's proposal exacerbates the difficulty that new program services will encounter in gaining access to cable systems as these systems increase their channel capacity in the years ahead.

Section 4 demonstrates how the Commission's proposal introduces a bias into the process by which programming on cable television systems is determined. This bias works against program services that depend on direct payments from subscribers, and favors services that are supported by merchandise sales or infomercials. The result is that program services that are highly valued by viewers can be displaced by less valuable leased access programs.

Section 5 explains why the Commission's proposal fundamentally ignores the problem of migration and could result in substantial shifts of existing program services to leased access status and a sizable loss of earnings to cable operators.

2. A Critique of the Commission's Proposal

In the face of channel capacity constraints and unrestricted competition, a new program service can displace an incumbent service only by promising to pay higher net revenues (subscriber and local advertising revenues less affiliate fees) than the incumbent service. Competition among program services thus ensures that the channels of a cable system are put to their highest value uses. In this section, we explain why the Commission's proposal for a new leased access fee calculation is likely to cause significant economic harm to cable operators because it results in fees that fail to cover an operator's opportunity costs when an existing program service is displaced by a leased access programmer.

a. *The Commission's Proposal*

The Commission has proposed an alternative to the maximum implicit access fee approach that it has previously employed to determine the leased access fees that cable operators can charge.[2] The Commission indicates that it "generally agree[s]...that the value of leased access channels 'is the opportunity cost imposed on the operator from the lost chance to program these channels.'"[3] Further, the Commission agrees "that cost should be the fundamental basis for establishing maximum leased access rates."[4] Finally, the Commission agrees

[2] The implicit access fee is the amount by which a cable system's net revenues increase when it adds a program service to its line-up. The Commission's reasons for limiting the fee operators can charge to an estimated maximum implicit access fee are discussed in Section 5.

[3] Order, para. 61, quoting a Time Warner petition

[4] Id.

"that the maximum rate could become a market rate when the statutory set-aside requirement is met."[5]

The Commission begins its analysis by indicating its belief "that the goal of the maximum rate should be to promote the use of the leased access set-aside channels without imposing an undue financial burden on the operator."[6] It then tentatively concludes that "when the set-aside capacity is not leased to unaffiliated programmers...the maximum rate should be based on the operator's reasonable costs (i.e., the costs of operating the cable system plus the additional costs related to leased access) including a reasonable profit."[7] In particular, the Commission notes:

> The intent of the cost formula is to permit the operator to continue to recover the same proportion of operating costs from subscriber revenues as were recovered before the channel was used for leased access. Thus, under the proposed cost formula, <u>the operator would not be adversely affected in terms of its ability to pay operating costs</u>.[8]

Under the proposed formula,

> Some of the costs [that the operator would be permitted to recover] are associated with removing or 'bumping' non-leased access programming to accommodate leased access programming; others are the direct costs associated with the specific leased access programmer or its programming. ... (W)e refer to all of these costs as opportunity costs. ... (T)he operator would be allowed to recover only those types of opportunity costs which can reasonably be

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[5] <u>Id.</u>

[6] <u>Order</u>, para. 65.

[7] <u>Order</u>, para. 66.

[8] <u>Order</u>, para. 67, emphasis added.

attributed to carriage of the leased access programming and which are reasonably quantifiable.[9]

If the access fee is set too low, the demand for leased access channels may exceed the number available under the leased access requirement. The Commission proposes to resolve this issue by allowing the access fee to rise to a market-clearing level if there is excess demand at the initial fee.

b. The Flaws in the Commission's Proposal

The theory advanced by the Commission to justify its new access fee proposal is that "the operator would be allowed to recover only those types of opportunity costs which can reasonably be attributed to carriage of the leased access programming and which are reasonably quantifiable."[10] Further, "the opportunity costs would be derived from the programming that is actually bumped from the operator's programming line-up."[11]

In practice, the Commission's approach to the issue of displacement of existing services, to which the current proposal is directed, is excessively narrow and based on a misunderstanding of the economics of cable system operation. In particular, when a cable operator must displace another program service in order to carry a leased access programmer, the costs to the operator in terms of foregone implicit access fees may be substantial. However, the Commission

[9] Order, para. 69.

[10] Id.

[11] Order, para. 75.

would permit the operator to recover only certain identifiable costs from channel lessees regardless of the true opportunity cost that is imposed by the displacement. As a result, the Commission's approach would leave many of the cable operator's costs unrecovered.

The Commission's approach is to calculate the maximum fee as the lost local advertising revenues from the displaced service minus the affiliate fees that are saved when the service is dropped. Because local advertising revenues are typically small relative to affiliate fees, the Commission's proposed approach appears to result in a zero leased access rate for many, if not most, cable systems.

3. The Impact of the Commission's Proposal on Cable Operators

Many of the flaws in the Commission's proposed approach stem from an erroneous view of the nature of the service that cable operators offer to their subscribers. Apparently, the Commission believes that its proposal is needed to avoid "double recovery" because it assumes that basic subscriber revenues will be unaffected when a cable operator replaces a number of existing program services with leased access programming on the same tier. There are at least two problems with this assumption.

a. The Direct Reduction in Cable Operators' Net Revenues

First, even if the revenues generated by a service were independent of the other services offered on the same tier, it would not be the case that displacing a cable service with a leased access programmer would not affect subscriber revenues.[12] Cable operators expend considerable effort to determine which program services are most valued by their subscribers so as to increase their own profits. A cable operator will add services only if they generate sufficient subscriber and local advertising revenues to cover, at a minimum, the costs of acquiring the service and activating a channel. Moreover, the collection of offered services is the one that the operator believes will make the largest contribution to covering its operating and investment costs.

When a cable operator adds program services, it increases the total revenue flow from subscribers, advertisers, and merchandise sales. Subscriber payments rise when the cable product is enhanced because the subscriber base is broadened, subscriber rates are increased, or both. In turn, advertisers' expenditures increase when the cable product attracts and retains more subscribers; commissions from home-shopping services also may rise. At the same time, the cable operator must make additional outlays in the form of payments for programming. A cable operator will add a program service if it expects that additional revenues minus additional outlays for programming exceed the incremental costs it incurs when it uses the channel on which the service is carried.[13]

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[12] This assumption is more misleading the greater the number of cable program services that are displaced.

[13] If the cable system is capacity-constrained, the operator will carry those services that provide the largest profits.

When, for example, a cable operator adds a program service that produces an additional $150 in subscriber revenues and an additional $50 in local advertising revenues, and for which the operator must make a payment of $75 to the service for its carriage, the operator obtains net revenue of $125 [=150+50-75].[14] If this amount exceeds the incremental cost of the channel used for the service, the operator will choose to carry the service. Thus, if the incremental cost of using the channel is $25, it is profitable to carry the service because doing so adds $100 [=125-25] to the profits of the operator.[15]

The difference between net revenues and incremental channel costs provides the resources used by cable operators to cover the costs of constructing and operating their cable distribution systems. Indeed, this amount must at least equal these capital costs, including a normal return to the operator, if the operator is to find it profitable to build, or rebuild, the system. A cable operator must receive substantial net revenues in order to be able to cover its costs, so the "contributions" from program revenues are critical to the financial viability of cable systems.

[14] This calculation ignores the effects of the carriage of the service on the revenues of other services. This factor is discussed below.

[15] For a system that has unused or "dark" channels, the incremental cost of using the channel consists of the outlays that the operator must make to transmit the additional service. For a system that has no unused channels, the incremental cost is the net revenue of the service that must be displaced.

A cable operator will wish to offer its subscribers the mix of services that maximizes the sum of the net revenues it collects.[16] When the optimal mix is offered, even if the net revenue of each service is independent of the presence of all other services, the operator cannot increase total net revenues by deleting one service and replacing it with another, or by adding or deleting any service. As a result, if a cable operator were to displace one or more of these services, its net revenues would decline through a combination of reduced basic subscriber fees (or an inability to raise fees), lost basic subscribers, and lost local advertising revenues. However, the Commission's proposed approach permits the recovery of only the last of these amounts. Indeed, because many of the services that might be dropped produce local advertising revenues that are smaller than their affiliate fees, the calculated implicit access fee for these services would be negative if the Commission's approach were adopted.[17] If the theory underlying the Commission's calculation were true, the cable operator could have earned higher profits by electing not to carry these services in the first place and, indeed, its profits could be maximized by dropping those services with the highest affiliate fees.

[16] This assumes that the incremental channel costs are the same for all services. If the incremental costs of adding particular services vary, this will become a factor in determining the mix of programming provided.

[17] TCI has calculated the maximum fees under the Commission's proposal for six of its systems. Each of these systems has a significant number of services for which the Commission's calculation yields a negative access fee.

b. The Indirect Reduction in Cable Operators' Revenues

The second, and more subtle, problem with the Commission's approach to calculating the opportunity cost of the displaced services is that it ignores important interdependencies among the values of the various program services offered by a cable operator. The objective of the cable operator is to offer not simply a set of individual services but a mix of services that different potential subscribers will value. Just as a newspaper offers its subscribers a mix of local, national, financial, and sports news; syndicated columns; a crossword puzzle; a horoscope column; a collection of cartoons; and information about cultural and artistic events, among other things, a cable system offers its subscribers a mix of general entertainment programming, sports services, news and public affairs programs, weather information, and home-shopping services, among others. This mix is chosen so as to maximize the contribution of the offered services to covering the system's capital costs.

Not all consumers value the same collection of services; accordingly, the way in which the package is assembled is important. For example, some viewers may value the sports services, others the news and public affairs channels, still others a mixture of the cultural and movie services.[18] There are also likely to be viewers who value some news and sports services and others who value some news and cultural services. Although not every potential viewer

[18] The same observation is true about newspapers. Some people would cancel their subscriptions if financial information were not offered, as would others if there were no sports news.

will value the same programs, the operator hopes that by offering a judiciously selected mix of services, its overall service will achieve a wide appeal.

This analysis implies that an operator may be willing to offer attractive carriage terms to a provider of high-quality programming that would increase the operator's subscriber base and produce higher local advertising revenues on other services, i.e., that would create spillover effects that are valued by the cable operator. The payment by the cable operator to the service for these spillovers is reflected in a higher affiliation fee.[19] The Commission recognizes that some programming will create significant positive benefits for other program services and for the cable operator, but it does not incorporate such benefits into its calculation of opportunity costs.[20]

The value of the cable package to any particular viewer may be reduced considerably if the services that he or she values are removed to make room for leased access programmers. Any resulting canceled subscriptions, in turn, reduce the implicit fee that other program services are willing to pay for access to the system. Thus, the indirect value to the operator of carrying the service may be substantial, although difficult to quantify. Put another way, the contributions of a service to the economic success of the operator are unlikely to be taken into

[19] An analogy may be helpful here. So-called "anchor" stores in shopping malls are often able to negotiate attractive leasing terms from developers because their presence attracts customers who patronize other stores that can be charged higher rents as a result.

[20] The Commission observes that a negative opportunity cost, if calculated under its proposed formula, understates the true value of carrying the incumbent program because it "does not include an approximation of the value of subscriber penetration" (Order, para. 88).